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THE FLAVORED MALT BEVERAGE COALITION'S COMMENTS ON TTB NOTICE NUMBER 4 FLAVORED MALT BEVERAGES AND RELATED PROPOSALS

October 21, 2003

Flavored Malt Beverage Coalition
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Tele.: 203-222-0579

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I. INTRODUCTION

The Flavored Malt Beverage Coalition ("FMBC") hereby submits these comments on Notice 4, Flavored Malt Beverages and Related Proposals.1 FMBC members agree with Notice 4 that the Alcohol & Tobacco Tax & Trade Bureau (“TTB”) should take the lead in developing regulatory standards for flavored malt beverages (“FMBs”), as they represent a significant and growing part of the beer market. FMBC respectfully disagrees with the 0.5% alcohol by volume (“ABV”) standard proposed in Notice 4, however, and urges TTB to adopt instead the more reasonable majority standard requiring that more than 50% of the alcohol in an FIVIB derive from fermentation of the product’s beer/malt beverage base. FMBC’s reasoning and its comments on other parts of Notice 4 follow.

FMBC’s members represent a broad spectrum of the alcohol beverage industry, from very large international companies to regional breweries. See List of FMBC Members, Exhibit 1. Together, FMBC members marketed and/or produced approximately 56% of the FMBs sold in the United States last year. As companies that collectively spent hundreds of millions of dollars to develop products now threatened by a change in federal policy, FMBC members have a particular interest in the outcome of the present rulemaking.

We begin these comments with the historical background that underlies and informs the present “controversy” over FMBs, particularly their formulation. Part Ill summarizes FMBC’s comments, followed by a more detailed explanation of those comments in Part TV. Part TV has seven major parts, containing: (A) the reasons a final rule should adopt a majority standard instead of the proposed 0.5% standard; (B) the reasons TTB lacks the statutory authority to limit the alcohol contribution of flavors to products classified as “beer” and “malt beverages;” (C)

1 68 Fed. Reg. 14291 (Mar. 24, 2003). See also 68 Fed. Reg. 32698 (June 2, 2003) (extending deadline for (9 comments to October 21, 2003).

other coniments related to FMB formulation; (D) clarifications to the proposed malt beverage

labeling and advertising provisions; (E) the reasons a final rule should not limit alcohol content

labeling solely to malt beverages containing non-beverage flavors; (F) a brief rebuttal of the primary arguments employed by supporters of a 0.5% standard; and (G) comments concerning the Paperwork Reduction Act and the Regulatory Flexibility Act.

II. HISTORICAL BACKGROUND TO THE COMMENTS

1. The First FMBs

As TTB recognizes, see 68 Fed. Reg. at 14295, 14296, federal policy has long permitted brewers to add non-beverage flavors containing alcohol2 to create products taxed as "beer" under Chapter 51 of the Internal Revenue Code ("IRC"), 26 U.S.C. §§ 5001-5691, and classified as "malt beverages" under the Federal Alcohol Administration Act ("FAA Act"), 27 U.S.C. §§ 201-

211. FMBs trace their origins to the 1940s and first became a relatively important part of the market in the late 1960s, when the first generation of FMBs gained popularity as an alternative to

the "pop wines" of the time. Those early FMBs included well-known brands like Champale and Malt Duck and resembled today's FMBs in many respects: Brewers added substantial amounts of water and sweeteners (sucrose, fructose, etc.) to a relatively small malt beverage base, used techniques to minimize the hop flavor of such products, and added non-beverage flavors that contributed flavor and alcohol to the finished product. And like today's FMBs, those groundbreaking products prompted considerable controversy as competitive interests sought to impose new regulations on the products. See Memo from unnamed author, to Commissioner of Internal Revenue, dated Dec. 9, 1970, Exhibit 2.

2 These comments use the term "non-beverage flavors" to refer to flavors deemed "unfit for beverage purposes" and containing alcohol. See 26 U.S.C. § 5131.

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TTB ‘s predecessor agencies were well aware of the early development of FMBs, as

federal policy since the 1950s required brewers to submit for review and approval a statement of

process (“SOP”) for any beer produced with non-standard ingredients like flavors. See Industry

Circular 57-17 (July 2, 1957). The SOP – a type of recipe – notifies the Agency of all ingredients used in the product, and must state a quantity or quantity range per ingredient that a brewer must adhere to during actual production. Thus, federal regulators have approved the addition of non-beverage flavors to beer/malt beverage products for over thirty years. Indeed, a 1971 Revenue Procedure specifically addressed the addition of flavoring materials to a malt beverage. See Revenue Procedure 71-26; Industry Circular 71-19 (Aug. 4, 1971).

The next significant development in the history of FMBs arose from a different drink category – the wine cooler. Becoming popular in the early and mid-1980s, the wine cooler combined a fermented wine base with water, sweeteners and non-beverage flavors. The category soon included a myriad of products that tasted totally unlike their grape wine base. As early as the mid-1980s, nationally-distributed wine cooler brands derived substantial amounts of alcohol from their non-beverage flavors. See In Matter of Miller Brewing Co., Transcript of the Proceedings, Feb. 20, 2003, Testimony of Expert Witness Vincent Ficca (“Ficca Test.”), Exhibit 3, at 44-47. FMBC knows of no federal regulation or policy then or now that restricts the amount of alcohol non-beverage flavors can contribute to a wine cooler, or any other wine product.

2. The Second Generation of FMBs

The wine cooler spawned a second generation of FMBs when cooler producers converted from a wine base to a beer/malt beverage base. In the mid-1980s, the Stroh Brewery and Canandaigua Wine Company marketed “cooler” products with a malt beverage base instead of

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wine. The development of the malt-based cooler accelerated in the late 1980s with the

introduction of the “Seagram Spritzer.” By the early 1 990s, other Seagram cooler products,

which originally contained a base of wine, converted to a malt beverage base. See id. Other popular cooler products quickly followed Seagram’s lead, most notably the Bacardi Breezer brand family and E. & J. Gallo’s Bartles & James brand family. Many of this second generation of FMBs shared all the salient characteristics of today’s most popular FMBs because they: (1) derived a substantial majority of their alcohol from added non-beverage flavors, not the fermented base; (2) bore the names of well-known distilled spirit brands (e.g., Bacardi, Seagram);3 and (3) did not resemble traditional malt beverages in color, aroma or taste.

The companies that created the second generation of FMBs over a decade ago built upon what they believed was a solid regulatory foundation. TTB ’s predecessor agencies had recognized since at least the early 1970s that brewers were adding non-beverage flavors to malt

C beverages. See Revenue Procedure 71-26, 1971-2 C.B. 566. In 1980, ATF adopted the then-most recent edition of the beer industry’s Adjunct Reference Manual (the “BARM”). See

Industry Circular 80-3 (Mar. 10, 1980). That edition of the BARM and all subsequent editions list ethyl alcohol as a permitted adjunct for use in flavoring malt beverages. See Excerpts of BARM, 1998 Ed., Exhibit 4, Sec. 4, p. 37. Moreover, in the words of the BARM, “ATF has approved the use of the adjunct without an indication to the limitation on use.” Id. at Sec. 4, p.

50. ATE repeated this lack of any limitations in communications with industry members like the attached 1987 letter stating that the use of flavors is limited only by “any use limitations applicable to the ingredients in each flavor.” See Letter from ATE to an Unnamed Industry

3 FMBC accordingly disagrees with Notice 4’s statement that only “newer” FMBs employ distilled spirit brand names. See 68 Fed. Reg. at 14297.

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Member, dated June 18, 1987, Exhibit 5, at 2. The use limits appear in the Food & Drug Administration's food safety regulations, which place no limit on the use of alcohol in flavors.

FMB producers also relied on specific federal actions in creating the second generation of FMBs. Most fundamentally, of course, ATF, continuing a policy established in 1957, reviewed and approved the SOP for each and every FMB produced in the United States or imported from abroad,4 and it incorporated that policy into its regulations in 1988. See 27 C.F.R. § 25.67. ATF's approval of these SOPs endorsed the use of non-beverage flavors up to the quantities indicated in the SOPs, and high-level Agency officials were briefed on these developments and their implications over ten years ago. See Memorandum from Charles N. Bacon, to Chief, Wine and Beer Branch, dated June 1, 1992, Exhibit 6. ATF also reviewed and approved a certificate of label approval ("COLA") for every FMB label. See 27 U.S.C. § 205(e); 27 C.F.R. §§ 7.30, 7.41.

3. ATF Ruling 96-1

On February 26, 1996, ATF published Ruling 96-1, which responded to reports received by ATF that an industry member planned to develop a high-alcohol FMB using non-beverage flavors as its primary alcohol sourcei Interpreting the FAA Act only, the Ruling recognized that FMIBs "containing a significant amount of alcohol derived from added flavoring" existed in the market, but that none contained more than 6% ABV in total alcohol. Thus, ATF held that it would not limit the alcohol in FMBs containing not more than 6% ABV, subject to rulemaking "in the near future." For products containing more than 6% ABV, Ruling 96-1 limits the

4 lmported products must submit to a pre-import analysis, which is functionally the same as the SOP process.

5 For an explanation of why the nature of non-beverage flavors inherently limits the alcohol content of beers and malt beverages deriving a majority of their alcohol from those flavors, see Part IV.B.2, infra.

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contribution of alcohol from flavors to not more than 1.5% of the total alcohol in the finished product. Finally, the Ruling required all SOPs for products containing non-beverage flavors to include detailed information about the alcoholic strength of their ingredients and the alcohol sources in the finished product.

ATF abandoned its pledge to conduct rulemaking soon after the publication of Ruling 96-

1. The law requires all federal agencies to publish a “Semiannual Regulatory Agenda” setting forth all pending and active rulemaking projects in order to inform interested members of the public what regulatory changes they can expect. See 5 U.S.C. § 602(a). Yet in Semiannual Regulatory Agenda filings published in the 1990s after Ruling 96-1, ATF never once indicated that it was planning or even considering new regulations that would limit the use of non-
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beverage flavors in products classified as beer or malt beverages. In fact, the Agenda’s only

mention of flavored malt beverages during this period referred to possible new malt beverage standards of identity “to recognize new categories of malt beverages as class and type designations for malt beverages with flavorings and other materials added.” 62 Fed. Reg. at 22182 (Apr. 25, 1997); 61 Fed. Reg. at 62990 (Nov. 29, 1996). By late 1997, the Agenda listed this possible rulemaking as “withdrawn” for further study, see 62 Fed. Reg. at 57963 (Oct. 29, 1997). and it completely disappeared from the Agenda by the end of 1998.7

6 61 Fed. Reg. 62989-62997 (Nov. 29, 1996); 62 Fed. Reg. 22181-22189 (Apr. 25, 1997); 62 Fed. Reg. 57955-

57963 (Oct. 29. 1997); 63 Fed. Reg. 22480-22487 (Apr. 27, 1998); 63 Fed. Reg. 62224-6223 1 (Nov. 9, 1998); 64 Fed. Reg. 21766-21775 (Apr. 26, 1999); 64 Fed. Reg. 64887-64895 (Nov. 22, 1999).

7 Abandoning a rulemaking is not unusual, and TTB predecessor agencies often have announced plans for future rulemaking that never materialize. See, e.g., Industry Circular 2000-2 (July 6, 2000) (stating that “within the next few months” ATF will publish a notice of proposed rulemaking addressing the exportation of alcohol beverages); Ruling 80-3 (stating that ATF will “thorougbly air” the classification, labeling and advertising of light beer “in a rulemaking proceeding”).

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Other actions by ATE in the late 1990s further confirmed that the Agency would not

proceed with rulemaking to limit the use of non-beverage flavors in FMBs. ATF continued to

review and approve SOPs and COLAs for FMB products and did not "qualify" those approvals pending further rulemaking – a common practice when possible new regulations could affect the validity of such approvals. Moreover, although Ruling 96-1 held that SOPs for FMBs should include detailed information about their alcoholic ingredients and alcohol sources, ATE did not enforce this requirement until the publication of Ruling 2002-2 in April of last year. See Ruling 2002-2; Industry Circular 2002-4 (Apr. 8, 2002).

4. The Third Generation of FMBs

Beginning in 1999, a third generation of FMBs began to gain unprecedented popularity with American consumers. The category was spurred by the runaway success of a new product, Mike's Hard Lemonade, quickly followed by other new "hard" lemonades and teas. The new FMBs differed from coolers primarily by focusing on one or a few brands and deliberately attempting to court the mainstream beer drinker. Like their predecessors, most third-generation FMBs derived a substantial majority of their alcohol from flavors and did not look or taste like conventional-tasting beer.

One of the products introduced in the late 1990s, Tequiza, broke new regulatory ground in two respects. First, Tequiza's brand name did not merely invoke a distilled spirits brand (e.g., Bacardi, Seagram) but, instead, played off a recognized distilled spirit type, tequila. Cf 27 C.F.R. § 5.22(g) (identifying tequila as a class of distilled spirit). Second, Tequiza's labeling and, later, advertising trumpeted that it contained "a natural flavor of imported tequila." See Tequiza COLA, Exhibit 7; Tequiza Newspaper Advertisement, Exhibit 8. Tequiza's reference to a distilled spirit standard of identity (tequila) prompted at least one distilled spirit wholesaler to

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inquire about the product's status with ATF. Writing in response, an ATF official indicated for the first time in four years that the Agency was considering rulemaking concerning the addition of non-beverage flavors to FMBs. See Letter from William Foster, to William Golciring, dated June 22, 2000, Exhibit 9. In the letter and in several discussions with industry members and representatives, that ATF official suggested that the Agency would limit the contribution of flavors to "not more than 25% of the total alcohol in the final product." Id. at 4.

ATF's apparent renewed interest in limiting the use of flavors in FMBs caused considerable concern among both established and new players in the FMB market. A number of FMBC's members met with TTB officials in the summer of 2000 to leam more about the Agency's plans. They received several assurances that ATF planned no change in policy towards the addition of alcohol to malt beverages containing 6% ABV or less. Those assurances came from the highest levels within the alcohol-responsible parts of the Agency, including Deputy Assistant Director Donald McVean.

The success of hard lemonades and teas and the assurance of regulatory stability soon prompted the introduction of proprietary FMBs that, like the Bacardi- and Seagram-branded products before them, bore the names of well-known distilled spirit brands. The first, Smimoff Ice, was introduced late in 2000, soon followed by new FMBs from all three major domestic brewers, often partnered with large distilled spirit brand owners. Building on the precedent established by Tequiza, several of these later FMBs employed distilled spirit standards of identity (e.g., rum, vodka) in the product's statement of composition to describe ingredients. See Selected COLAs for Flavored Malt Beverages, Exhibit 10; cf 27 C.F.R. § 7.24(a) (requiring a statement of composition for products "not known in the trade").

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The introduction of FMBs declaring that they were made with a “flavor containing vodka” in early 2002 caused substantial controversy. In response, ATF published Ruling 2002-2 on April 8, 2002. See Ruling 2002-2; Industry Circular 2002-4. The Ruling returned federal policy to its pre-Tequiza state: A malt beverage can employ the brand name of a well-known distilled spirit or the name of a mixed-drink cocktail as their brand or fanciful names. The use of distilled spirit standards of identity, however, is prohibited in a malt beverage statement of composition, and is presumed misleading if appearing elsewhere on the labeling or in the advertising of a malt beverage. In spite of this policy correction, the controversy precipitated by TTB’s change in FIvtB labeling policy has led to Notice 4.

III. SUMMARY OF COMMENTS

FMBC agrees with TTB and concerned state authorities that the federal government should establish clear, consistent standards for the formulation of FMBs. But Notice 4 does not adequately explain why such a standard should limit the alcohol contribution of non-beverage flavors to just 0.5% ABV instead of the more reasonable majority standard, which TTB acknowledges is permissible under federal law. TTB fails to produce any evidence of consumer confusion to support its rulemaking and, indeed, the available evidence demonstrates that consumers do not care about the alcohol source in an FMB. Notice 4 also fails to explain why either of its stated reasons for acting — alleged consumer confusion and the concerns of state regulators — are better served by a 0.5% standard versus a majority standard. Given the absence of a compelling reason for selecting a 0.5% standard over a less-restrictive one, societal costs like the additional $154.3 million in likely costs that a 0.5% standard would impose on FMBC members and the $85.5 million in lost federal revenues loom especially large.

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Furthermore, although FMIBC is willing to accept and its members are willing to stretch in an attempt to satisfy a reasonable FMB formulation standard, neither the IRC nor the FAA Act give TTB the statutory authority to limit the use of non-beverage flavors in a “beer” or “malt beverage.” The text of the definitions, statutory context, historical context and the legislative history of both statutes demonstrate that Congress did not intend to limit the use of non-beverage flavors in a beer or malt beverage beyond the inherent limits imposed by the nature of non-beverage flavors themselves.

FMBC also urges TTB to re-think the language used in several of Notice 4’s proposed regulations. Most notably, TTB should propose regulations to begin the process of articulating standards by which beer and malt beverage samples will be evaluated under Notice 4’s proposed formula system. In incorporating existing policy towards the use of distilled spirit brand names and standards of identity into the malt beverage regulations, TTB should take more care to avoid the suppression of truthful, non-misleading information protected by the First Amendment. Finally, although FMBC agrees that alcohol content labeling gives consumers important information, we see no reason why Notice 4 singles out malt beverages containing non-beverage flavors as the only malt beverages required to bear an alcohol content statement.

IV. COMMENTS

A. TTB SHOULD ADOPT A MAJORITY STANDARD AND REJECT THE MORE RESTRICTIVE 0.5% STANDARD

1. Introduction

Notice 4’s proposed new formulation standards for a product to qualify as a “beer” and/or a “malt beverage” profoundly threatens the FMB businesses of FMBC members. Those companies relied on longstanding federal policies to create beverages that consumers enjoy, and invested millions of dollars in promoting those brands. Although any change to established

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production methods will disrupt and possibly damage member companies' business, FMBC members are willing to make the substantial efforts necessary to adjust to a majority standard requiring that at least 50% of the alcohol in a beer/malt beverage derive from fermentation of the product's base. See 68 Fed. Reg. at 14296. The proposed 0.5% ABV limit in Notice 4, in contrast, presents a much more dire threat to existing business investment without a sound policy justification behind it. Indeed, support for the 0.5% standard appears to come from the many industry members who, for competitive reasons, would benefit from the complete demise of the FMB category or would derive a competitive advantage from a 0.5% rule.

2. TTB Bears the Burden of Justifying the Most Restrictive Standard

Underlying all the points that follow is the fundamental requirement that TTB justify why it has selected the most restrictive rule for its beer/malt beverage standard. Notice 4 concedes that neither the TRC nor the FAA Act articulate any specific limitation on the amount of alcohol non-beverage flavors can contribute to a beer/malt beverage. 68 Fed. Reg. at 14295 ("Neither the IRC nor the FAA Act provides a clear statement as to how much, if any, of a beer's or a malt beverage's overall alcohol content may come from added flavors"). Notice 4 further recognizes that TTB and its predecessor agencies have long permitted alcohol from flavorings to contribute alcohol to products classified as either beer or malt beverages. Id. ("we and our predecessors have long allowed flavors, including flavors containing alcohol, to be added to [beer] products"), Id. at 14296 ("We and our predecessors have considered flavorings containing distilled spirits to be wholesome food products and have allowed their use in producing malt beverages"). These facts naturally require Notice 4 to specifically concede that the law allows TTB to adopt a standard other than the proposed 0.5% ABV limit, including one that would require that only a

majority (more than 50%) of the alcohol in a beer/malt beverage derive from fermentation of the product's base. Id.

Where the government seeks to change longstanding policy and impose new regulations, it must bear the burden of justifying the proposed new regulations. See, e.g., JSG Trading Corp. v. United States Dep 't ofAgric., 176 F.3d 536, 544 (D.C. Cir. 1999); British Steel v. United States, 127 F.3d 1471, 1475 (Fed. Cir. 1997); see also Thomas Jefferson Univ. v. Shalala, 512 U.S. 504, 512 (1994). Thus, the question is not whether FMBC, its members, or anyone else can demonstrate why a 0.5% standard is impossible to meet. Instead, the burden falls on TTB to show why the added costs and taste uncertainty that a 0.5% standard will impose on FMB producers, marketers, distributors, retailers and consumers is justified by sound public policy. FMBC respectfully submits that TTB has not and can not satisfy this burden.

Notions of fundamental fairness further require that Notice 4 articulate a clear, consistent ti and compelling reason for changing federal policy, as the change will disrupt substantial business investments and consumer expectations. TTB and its predecessors have approved the use of non-beverage flavors in beers and malt beverages for more than thirty years. Further, TTB expressly adopted the BARM's approval of ethyl alcohol as a permitted flavor in products classified as beer and/or malt beverages, placing no limitations on their use. See Industry Circular 80-3. And beginning in the late 1980s, TTB approved hundreds (perhaps thousands) of SOPs permitting non-beverage flavors to contribute the vast majority of the alcohol in a beer product. Fairness dictates that Notice 4 attempt to accommodate persons who reasonably relied on these and other actions in making their business plans.

On the issue of reliance, FMBC must respectfully disagree with Notice 4's suggestion that Ruling 96-1 should have alerted FMB producers that a radical change in federal policy was

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imminent. As explained above, ATF did nothing to follow up on Ruling 96-1's promise of rulemaking "in the near future," and the published Regulatory Agendas for the Agency, which

the public and the industry must rely upon to monitor regulatory developments, never included the issue until the past few years. Any reasonable observer would have concluded by 1999 (the year companies began introducing third-generation FMBs into the U.S. market) that the Agency had abandoned further rulemaking plans. Moreover, when reports surfaced suggesting that ATF might revive rulemaking plans, interested industry members quickly sought and received assurances that no change in policy was contemplated.

Finally, TTB should avoid crafting a rule that hands a competitive advantage to some FMB producers at the expense of others. Although America's largest three brewers produce about 85% of the malt beverages sold in the United States and dominate the distribution channels for such products, they have been much less successful in selling their own FMB brands. The largest of those brewers now claim that they already can produce FMBs meeting Notice 4's proposed 0.5% standard without compromising product taste or availability. See Beer Institute

Handout at National Conference of State Administrators ("NCSLA") Meeting, June 9, 2003, Exhibit 11. This demonstration of big brewer reformulation capabilities illustrates that adopting a 0.5% standard will adversely affect competition in the malt beverage market by forcing competitors to acquire technologies and capabilities similar to those apparently possessed today by the biggest brewers. FMBC respectfully submits that where the law would support a standard deemed achievable by all EMIB producers, TTB should not favor a standard that will provide a competitive advantage to the beer industry's dominant players. Indeed, the marketplace, not the Government should determine industry winners and losers.

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3. Concerns About Consumer Confusion Do Not Support a 0.5% Standard

i. Introduction

Notice 4 cites the potential for consumer confusion as one of the two policy grounds for imposing limits on the use of non-beverage flavors in products classified as beer and/or malt beverages. Specifically, TTB asserts that "we believe that to label a beverage that derives most of its alcohol content from added alcohol flavors as a malt beverage is inherently misleading since consumers would expect that malt beverages derive a significant portion of their alcohol content from fennentation of barley malt and other ingredients at the brewery." 68 Fed. Reg. at 14296. This unsupported assertion does not withstand closer examination and, in any event, does not explain why a 0.5% standard is preferable to a less-restrictive standard that TTB believes the law would support.

ii. Notice 4 Fails to Demonstrate that Consumer Confusion Exists

Notice 4 can not rely upon consumer confusion as a justification for rulemaking when it

does not produce a single piece of evidence showing that consumers are, in fact, confused. To justify the rule, TTB must show two things. First, TTB must produce evidence to back up its assertion that use of the term "malt beverage" on a label leads consumers to believe that a significant portion of the product's alcohol derives from fermentation of barley malt and other ingredients at the brewery. Second, TTB must demonstrate that the consumer confusion it asserts actually affects consumers' purchasing decisions; i.e., that the confusion is material. See, e.g., Pizza Hut, Inc. v. Papa John's Int'l, Inc., 227 F.3d 489, 503-04 (5th Cir. 2000) (rejecting contention that an advertising slogan was misleading because the plaintiff failed to produce evidence demonstrating that the challenged slogan "had the tendency to deceive consumers so as to affect their purchasing decisions"); Gold Seal Co. v. Weeks, 129 F. Supp. 928, 934 (D.D.C.

1955) (where an allegedly deceptive claim “does not appear as determinative in leading customers to buy the product, the mark is not deceptive”). Notice 4 does neither: It contains no evidence of consumer confhsion, cites to no consumer survey, and does not point to a single consumer complaint about the alcohol source in FMBs. A final rule can not cure Notice 4’s lack of evidence on this point, as the Administrative Procedures Act, 5 U.S.C. § 553, requires TTB to give the public an opportunity to comment on the basis of new regulations.

Notice 4 can not rely on a bald assertion of consumer confusion. Federal court decisions examining the purported expertise of federal label review personnel demonstrate that mere assertions of administrative expertise, without more, do not carry TTB ‘5 evidentiary burden. See Cabo Distribution Co. v. Brady, 821 F. Supp. 601, 612 (N.D. Cal. 1992); Cabo Distribution Co. v. Brady, 821 F. Supp. 582, 597 (N.D. Cal. 1992). More fundamentally, the government can not

rely on “mere speculation and conjecture” to demonstrate that particular speech — here the use of the term “malt beverage” — misleads consumers. See Edenfield v. Fane, 507 U.S. 761, 770-7 1 (1993). Instead, it must meet an evidentiary burden that “is not slight” and imposes “on would-be regulators the costs of distinguishing the truthful from the false, the helpful from the misleading, and the harmless from the harmful.” Ibanez v. Florida Dep 't of Bus. & Prof Reg., 512 U.S. 136, 143 (1994). Indeed, in a phrase that might apply directly to Notice 4, the Supreme Court has explained that “we cannot allow rote invocation of the words ‘potentially misleading’ to supplant the [government’s] burden to demonstrate that the harms it recites are real[.]” Id. at 146; see also Pearson v. Shalala, 164 F.3d 650, 659 (D.C. Cir. 1999).

Notice 4’s failure to present any survey evidence to support its assertion of confusion is particularly telling. Today, federal courts examining the issue of consumer confusion virtually require such evidence to back up a claim of confusion. “[F] ailure to offer a survey showing the

existence of confusion is evidence that the likelihood of confusion cannot be shown." Essence Communications, Inc. v. Sing/i Industries, Inc. 703 F. Supp. 261, 269 (S.D.N.Y. 1988); see also

Braun inc. v. Dynamics Corp. ofAm.,975 F.2d 815, 828 (Fed. Cir. 1992). Nor can TTB belatedly publish a survey or other evidence of confusion when it publishes its final EMIB rules, as doing so would deprive the public of its opportunity to comment on this important information.

The Agency bears an even heavier evidentiary burden where, as here, Notice 4's assertion of confusion directly contradicts its predecessor's pronouncements on the same subject. See, e.g., JSG Trading Corp., 176 F.3d at 544 (agency changing policy must provide a "reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored"); Greater Boston Television Corp. v. FCC, 444 F.2d 841, 852 (D.C. Cir. 1970) (same). In 1996-97, ATE undertook a rulemaking project to ascertain whether federal law should prohibit

or restrict the use of distilled spirit cocktail names in the labeling and advertising of malt beverages. See 61 Fed. Reg. 57597 (Nov. 7, 1996). That Advanced Notice of Proposed Rulemaking generated over 5,000 comments, including several substantial surveys on the subject of consumer perceptions of malt beverages bearing well-known cocktail names. Based on a careful analysis of the evidence submitted, ATF decided not to pursue further rulemaking on the subject. On the question of consumer confusion, the Agency concluded:

Evidence introduced indicates that flavored malt beverages are viewed by consumers as coolers or low alcohol refreshers, and not as a distilled spirits product. Evidence introduced also indicates that the presence of distilled spirits or any similarity of these products to a distilled spirits drink is not a criteria in their selection by consumers.

Letter from Arthur J. Libertucci, to William L. Webber, dated Nov. 17, 1997, Exhibit 12, at 2. In

other words, just six years ago TTB 's predecessor agency concluded, after a formal notice-and-

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comment procedure, that consumers do not care about the alcohol source in an FMB. Notice 4 can not assert the contrary without any evidence to justify this about-face.

Moreover, evidence presented during the 1996-97 cocktail cooler rulemaking demonstrates that ATF correctly concluded that alcohol source is not material to FMB consumers' purchasing decisions. According to a 1995 consumer survey conducted for E. &. J. Gallo Winery, when consumers were asked why they bought Bartles & James Margarita Flavored Beverage, less than one-half of one percent of survey respondents mentioned that they thought the product contained tequila or other distilled spirits. See E. & J. Gallo Winery, Comment No. 926 on ATF Notice 844 (Feb. 3, 1997), Exhibit 13, at 9; #6510 Beverage Study, (Oct. 2, 1995), Exhibit 13, at 85-88. The survey respondents cited the product's lemon/lime taste and the Bartles & James brand name as the principal reasons for their selection of Bartles & James Margarita Flavored Beverage, not their perception that the product contained distilled spirits. Id. Overall, the Gallo survey determined that the source of alcohol in Bartles & James Margarita Flavored Beverage was immaterial to purchasing consumers. Id. Likewise, according to a 1995 consumer survey conducted for Joseph E. Seagram & Sons, Inc., only two out of 226 purchasers surveyed described Seagram's Margarita Flavored Coolers as containing tequila, and only one purchaser out of 226 stated that s/he selected the product because it contained tequila. See Joseph E. Seagram & Sons, Inc., Comment No. 902 on ATF Notice 844 (Feb. 3, 1997), Exhibit 14, at 10; Purchaser Perceptions of Seagram's Margarita Flavored Coolers (Dec. 1995), Exhibit 14, at 7. Thus, for 99% of the purchasers of Seagram's Margarita Flavored Coolers, the source of alcohol in the product was irrelevant to their purchasing decision. Id.

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iii. Consumer Protection Does Not Favor a 0.5% Standard

As explained above, Notice 4 presents no evidence of consumer confusion to support its consumer protection rationale and the available evidence and the conclusion of TTB 's immediate predecessor actually demonstrate that no consumer issue exists. But even assuming that a mere assertion of consumer confusion were sufficient, Notice 4 does not and can not explain why consumers' supposed expectation that malt beverages "derive a significant portion of their alcohol content from fermentation of barley malt and other ingredients," 68 Fed. Reg. at 14296, favors a 0.5% standard over the more reasonable majority standard. A product deriving more than half its alcohol from fermentation of barley malt and other ingredients meets TTB '5 asserted "significant portion" expectation of consumers. In fact, FMBC respectfully submits that it would be misleading to label a product made primarily from a malt beverage base as anything other than a malt beverage. Moreover, a host of other ingredient requirements demonstrate that federal policy under the IRC and FAA Act usually deems a majority or less to sufficiently meet consumer expectations about a particular ingredient. To rule on the basis of mere speculation that a different standard must apply to the alcohol source for malt beverages would be inconsistent and arbitrary.

TTB policy towards the very issue at the heart of the beer/malt beverage formulation standard — the source of alcohol — demonstrates that Notice 4 arbitrarily imposes a more rigorous standard on beer/malt beverages than on other products. Accepting for the moment that consumers know and care about the source of alcohol in the products they drink, then consumers presumably expect that the wines they purchase derive a significant portion of their alcohol from the fermentation of grapes and other fruits at the winery. Yet federal policy places no limit on the amount of alcohol that flavors can contribute to a wine product and, indeed, at least some

wine coolers at one time derived a majority of their alcohol from added non-beverage flavors. See Ficca Test. at 44-48. Federal law also allows wines to derive substantial amounts of alcohol from direct distilled spirits additions, yet TTB regulations prohibit labeling or advertising that would inform consumers about the presence of such added distilled alcohol. See 27 C.F.R. §§ 4.39(a)(7), 4.64(a)(8).8 Notice 4 never explains why allowing more than a de minimis amount of alcohol (0.5%) from other sources into a beer/malt beverage would mislead consumers of those products, while allowing the addition of substantial amounts of distillation alcohol to wines without disclosure to the consumer creates no consumer issue.

Similarly, assuming for the moment that consumers care about the source of alcohol in the products they purchase, Notice 4's proposed 0.5% standard stands in marked contrast with federal policy towards the source of alcohol in distilled spirit products. That policy permits some distilled spirits to derive up to half of their alcohol from added wine that was never subject to distillation. See 27 C.F.R. § 5.11 (definition of "distilled spirits"). This rule precisely mirrors the majority standard favored by FMBC, but is quite at odds with the far more restrictive 0.5% standard proposed by Notice 4. Once again, the Notice never explains why consumers of distilled spirits are not mislead, while beer/malt beverage consumers in the same circumstances would be.

A host of other federal regulations and policies demonstrate that TTB would act arbitrarily if it were to adopt, without any basis, a 0.5% standard when the law would support a

8 Less than four years ago, ATF specifically proposed a rule that would require wine labels to disclose the use of distilled spirits additions in certain circumstances, see 64 Fed. Reg. 72612, 72616-72617 (Dec. 28, 1999) (proposed 27 C.F.R. § 4.2 l(j)(l)), but did not adopt the proposed regulation in its final rule, see 65 Fed. Reg. 59718 (Oct. 6, 2000).

less restrictive standard that is closer to the current status quo. Those regulations and policies include:

o To qualify as a “malt beverage,” only 25% of the fermentable material in the product must derive from malted barley or a “substitute” for malt. See The Beverage Alcohol Manual (BAM), Malt Beverages (Vol. 3), ATF Pub. 5130.3 (7-2001) at 4-2. And as long as the product contains “some” malt, a brewer can satisfy that 25% requirement by using “grains of any kind, corn-starch, sugar, or molasses.” See Letter from Chief, ATF Trade and Consumer Affairs Division, to Associate General Counsel, Miller Brewing Co., dated Oct. 5, 1979 (“Miller Letter”), Exhibit 15, at 2.

o A “wheat beer” can contain as little as 25% wheat and a “rye beer” can bear that name if it derives just 5% of its fermentable ingredients from rye. See The Beverage Alcohol Manual (BAM), Malt Beverages (Vol. 3), ATF Pub. 5130.3 (7-2001) at 4-4 & 4-5.

o Wines bearing a named grape varietal designation can contain as little as 51% of the named grape type. See 27 C.IF.R. § 4.23(c).

o Products labeled “whisky” can contain as little as 20% whisky, provided that the label indicates that the product is “blended.” See 27 C.F.R. § 5.22(b)(4).

4. State Concerns Do Not Support a 0.5% Standard

Notice 4 relies on unspecified state concerns as the second rationale for imposing limits on the use of flavors in products classified as beer and/or malt beverages. See 68 Fed. Reg. at 14294, 14295, 14297. Notice 4 further explains that those concerns have prompted states to urge TTB “to define flavored malt beverages and establish regulatory limits on the addition of alcohol to beer and malt beverages through the use of flavors.” Id. at 14295. In the absence of such limits, states “have said that they will develop their own definitions for flavored malt beverages.”

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Id. FMBC member companies agree with the need for a national FMB formulation standard and, for that reason, urge TTB to adopt the majority standard discussed in Notice 4. We know of no state concerns, however, that would justify the imposition of the proposed 0.5% standard instead of the more reasonable majority standard.

It is worth noting that federal law remains independent of state law, and that state officials' views are not binding on TTB. TTB, of course, should attempt to accommodate state concerns where appropriate, and we commend Notice 4 for seeking to craft a national standard to respond to state concerns. Nevertheless, TTB should not regulate to the "least common denominator" and elevate the opinions of a few state regulators above other important considerations it must weigh in crafting an EMIB standard. Indeed, recent events demonstrate that state legislators, regulators and the industry can work together to make state law consistent with federal formulation policies. See, e.g., Mississippi Act of March 7, 2003, ch. 322, sec. 1, § 67-3-3, 2003 Bill Text MS S.B. 2507 (defining beer under Mississippi law as consistent with the FAA Act definition of "malt beverage"); Oregon Act of July 8, 2003, ch. 551, sec. 2, 2003 Bill Text OR H.B. 3130 (delaying action on FMB issue in anticipation of the promulgation of a national rule).

Like the federal government, all states today classify FMBs as "beer," "malt beverages" or an equivalent statutory term.9 The definitions of those terms vary from state to state, but many resemble in material respects one of the two federal definitions that TTB interprets as supporting the adoption of a new FMB formulation standard. Like those federal statutes, state statutes are silent on the issue of how much alcohol non-beverage flavors can contribute to a malt

9 Unlike Federal law, which uses both the terms "beer" and "malt beverages" under different statutory schemes, states generally adopt a single definition – either beer or malt beverage – for regulatory and tax purposes.

beverage. See, e.g., Cal. Bus. & Prof. Code § 23006; N.Y. Alco. Bev. Laws § 3(3). Even assuming this silence could support the imposition of limits on the use of flavors, then, the statute's silence allows state regulators to adopt either a majority standard, a 0.5% standard, or some other intermediate standard.

Some supporters of the 0.5% standard have suggested that the presence of a 0.5% ABV threshold in many state statutes requires those states to limit the alcohol contribution of flavors to that de minimis amount. As Notice 4 recognizes, however, statutory references to 0.5% do not address the formulation of products. Instead, the threshold is "the dividing point between an alcohol beverage subject to internal revenue tax and a beverage containing alcohol that is not subject to tax as an alcohol beverage." 68 Fed. Reg. at 14295. FMBC is aware of no state statute that sets 0.5% — or any other figure — as the mandatory limit on the amount of alcohol that flavors or other alcohol sources can contribute to a malt beverage. Indeed, were such an interpretation to prevail, many states would have to reclassify many wines, as state wine definitions often include the 0.5% threshold for taxation, see, e.g., Ark. Code Ann. § 3-7-104(5); Cob. Rev. Stat. § 12-47-102(39); Ohio Rev. Code Ann. § 4301.01(B)(3); Or. Rev. Stat.

§ 471.001(10), yet many wines derive considerable quantities of their alcohol from added distilled spirits or non-beverage flavors.

Moreover, while some states have expressed support for Notice 4, none to date have indicated that they can not accept a majority standard. Comments by state alcohol control authorities submitted in response to Notice 4 and available on-line near the close of the comment period can be characterized as follows:

No stated preference between 0.5% or majority: Four. Total includes California, Missouri, Oklahoma and West Virginia.

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o Support the 0.5% standard and can not support a majority standard: None.

o Support the 0.5% standard, with no comment on a majority standard: Eleven. Total includes Arizona, Kansas, Kentucky, Louisiana (but rulemaking irrelevant for regulatory purposes), Maryland, Mississippi, North Carolina, Pennsylvania, South Carolina, Tennessee and Virginia.

o May require legislation under a 0.5% standard or majority standard: Two. Total includes Arkansas and Georgia.

The fact that no state has labeled the majority standard unacceptable and relatively few have expressed a preference for 0.5% is hardly surprising. Last spring, the Joint Committee of the States (a body that represents the interest of alcohol regulators from both the "control" and "open" states) voted to recommend that states support a position that more than 50% of the volume of a finished FMB come from the product's beer/malt beverage base. See Letter from Randy Yarbrough, to Art Libertucci, dated May 9, 2003, Exhibit 16; David Goetz, Stricter Rules Urged on Malt Beverages, Louisville Courier-Journal at 1E, (May 9, 2002), Exhibit 17. Such a standard would be more lenient than the majority standard FMBC can accept.

5. A 0.5% Standard Would Impose Unnecessary Economic Costs On FMB Producers, Distributors, Retailers And Consumers

Notice 4's preference for a restrictive 0.5% standard would impose unnecessary economic costs on the FMB industry, the wholesalers and retailers that distribute such products, and ultimately on the millions of consumers that enjoy FMBs. As explained above, neither of the justifications cited by Notice 4 actually supports the 0.5% standard over the majority standard. The standard proposed in Notice 4 accordingly has little or no benefit and is not mandated by Congress. Yet, it would impose economic costs beyond the substantial costs already required to convert the industry to a majority standard.

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To measure the economic impact of Notice 4's new formulation standards, FMBC retained Economic Consulting Services, LLC ("ECS") to analyze data provided by member companies in order to estimate the economic impact of new rules on FMBC members, and on the industry in general. The ECS Report, Economic Impact of TTB 's Proposed Rule Changes Concerning Flavored Malt Beverages and attached as Exhibit 18 (the "ECS Report"), demonstrates that Notice 4 will impose significant costs on the industry. The ECS Report speaks for itself, but we briefly highlight those costs that a 0.5% standards will impose in addition to those FMIBC members already must incur in order to comply with a majority standard. Assuming an effective date for new rules of January 1, 2005, the direct costs of choosing the 0.5% standard over the majority include:

1) Expected loss in volume of 2.26 million barrels.

2) Additional up front capital costs of $10.8 million.10

3) Increased ongoing production costs of $900,000 in 2004, $3.1 million in 2005, $60.1 million in 2006 and $69.4 million in 2007.

4) A $127.8 million loss in operating income from FMB sales through 2007.

5) Capital losses of $15.7 million.

Thus, ECS estimated the total in upfront costs, lost operating profits and capital losses of a 0.5% standard to FMBC members as $154.3 million. TTB can not simply ignore this enormous figure.

The ECS Report further demonstrates that the societal costs of Notice 4's 0.5% standard would exceed the $154.3 million imposed on FMB members. Perhaps most importantly from a

10 The additional up front costs would be considerably higher except that several FMBC members expect to discontinue certain products altogether under the 0.5% standard.

public-policy perspective, ECS estimates that total federal tax payments by FMBC members in 2004-07 would fall by $85.5 million under a 0.5% standard — tax losses on top of the $77.9 million that ECS believes the federal treasury would lose due to the implementation of a majority rule. Moreover, applying the ECS tax analysis to the entire FMB industry indicates that a 0.5% standard could drop federal tax collections in 2004-07 by $152.7 million. Similarly, applying the ECS analysis of FMIBC members to the entire FMB market indicates that a 0.5% standard will cost the industry approximately $291.1 million.

B. TTB LACKS THE STATUTORY AUTHORITY TO LIMIT THE USE OF NON-BEVERAGE FLAVORS IN BEERS AND MALT BEVERAGES

1. Introduction

FMBC member companies are willing to apply their respective resources to adjust to a majority rule requiring that at least 50% of the alcohol in an FMR derive from fermentation of the product's beer/malt beverage base. Nevertheless, we believe that neither the TRC nor the

FAA Act gives TTB the authority to change its policy towards the use of flavors, particularly after many years of contrary policy. We begin with the TRC, which provides the primary basis for the regulations proposed in Notice 4— a marked contrast from the FAA Act-only analysis of Ruling 96-1.

2. The Internal Revenue Code Does Not Permit TTB To Limit The Use Of Non-Beverage Flavors In Beer

Notice 4 errs in asserting that the IRC definitions of "beer" and "distilled spirits" allow TTB to limit the use of non-beverage flavors in beer, and to tax any product deriving amounts of alcohol in excess of that limit as distilled spirits. To the contrary, the text of the beer definition, its interaction with other IRC provisions, and the Code's legislative history all demonstrate that Congress never intended to limit the use of non-beverage flavors in products taxed as beer.

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The definition of beer in the IIRC gives brewers substantial discretion in formulating their products. By requiring brewers only to use malt “wholly or in part” or “any substitute therefor,” the Code allows a brewer to use an almost limitless set of food ingredients besides malted barley

and hops. See 26 U.S.C. § 5052(a). Moreover, by including sake and products “of any name or description,” the statute clearly classifies as beer beverages that do not possess the look, taste and aroma of “conventional” beer. See id. Federal policy has long allowed brewers to use

processes to remove color, flavor, or character” from beer, and FMBC supports proposed Section 25.55’s incorporation of that policy into regulations. See 68 Fed. Reg. at 14302.

Any doubt over the proper classification of FMBs under the TRC is erased by the tax on “products containing distilled spirits.” See 26 U.S.C. § 500 1(a)(2). Notice 4 states that the

IRC’s beer definition supports a rule classifying a beer containing 0.5% or more ABV derived ,— from non-beverage flavors as a distilled spirits product. See 68 Fed. Reg. at 14295. The

“products containing distilled spirits” provision of the IRC, however, precludes such a

reclassification. This provision, while crucial to understanding the legal basis for Notice 4, is never addressed in the Notice or in the Chief Counsel’s memorandum opining that “a sufficient legal basis” exists for changing Agency policy towards FMBs due to the presence of alcohol

from non-beverage flavors. See Memorandum from Chief Counsel, to Deputy Assistant Director (Alcohol and Tobacco), undated, Exhibit 19 (“Counsel Opinion”).

The IRC defines products containing distilled spirits as: “All products of distillation, by whatever name known, which contain distilled spirits, on which the tax imposed by law has not been paid, and any alcoholic ingredient added to such products, shall be considered and taxed as distilled spirits.” 26 U.S.C. § 500 1(a)(2) (emphasis added). The TRC therefore treats products

containing a mix of distilled alcohol and other material (like FMBs) as distilled spirits only if the

distilled alcohol was not otherwise taxpaid under federal law. Non-beverage flavors are subject to excise tax; the law merely pennits the manufacturers of flavors deemed “unfit for beverage purposes” to claim drawback on a portion of the excise taxes imposed on the alcohol component of the flavors. See id. at §§ 5131, 5134(a). For this reason, federal policy deems the distilled spirits used in non-beverage flavors taxpaid. See, e.g., 26 U.S.C. § 513 1(a) (non-beverage drawback provision applies to distilled spirits “on which the tax has been determined”); 57 Fed. Reg. 39536, 39537 (Aug. 31, 1992) (explaining tax status of distilled spirits used in non-beverage flavors). Notice 4 itself acknowledges that the alcohol contained in flavors and flavoring extracts is “taxpaid.” See 68 Fed. Reg. at 14294. Thus, non-beverage flavors and the alcohol they contain are not products “on which the tax imposed by law has not been paid,” and their addition to a beer can not render the resulting beverage a “product containing distilled spirits.” Notice 4 accordingly errs in suggesting that the presence of distilled alcohol added through non-beverage flavors can make a product taxable as a distilled spirit.

Review of the alcohol excise tax provisions of the IRC further reinforces the conclusion that Congress did not intend to place limits on the use of non-beverage flavors in beer, aside from the inherent limit imposed by the requirement that non-beverage flavors be “unfit for beverage purposes.” See 26 U.S.C. § 513 1(a). Where a statute includes explicit limits on certain categories but none for a different category, the principle of expressic unius est exciusic alterius will deem the statute’s silence as an affirmative expression that Congress intended no limit See, e.g., Gomez V. United States, 490 U.S. 858, 871-72 (1989); Tennessee Valley Authority v. Hill, 437 U.S. 153, 188 (1978). Significantly, Congress provided explicit limits on the addition of non-beverage flavors to distilled spirits (for purposes of tax-free treatment) and limits on the direct addition of distilled spirits to wine. See 26 U.S.C. §§ 5010(c)(2)(B)(iii), 5373. Congress

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placed no similar limits on the use of non-beverage flavors in wine and beer and, indeed, TTB has never limited the amoi.int of alcohol that flavors can contribute to a wine. Treating beer differently offends elemental notions of statutory construction.11

The IRC does place a practical limit on the amount of alcohol that non-beverage flavors can contribute to a beer. A flavor must taste extremely unpleasant when undiluted in order to qualify as "unfit for beverage purposes." 26 U.S.C. § 5131(a). A brewer adding substantial quantities of such flavors to a beer wotdd soon render the finished product undrinkable. To achieve drinkability, then, a product deriving a substantial portion of its alcohol from flavors requires significant dilution using a non-alcoholic liquid. The unfit for beverage purposes standard accordingly ensures that any beer or malt beverage deriving alcohol from flavors would not exceed the alcoholic strength achievable through fermentation.

The legislative history of the lIRC reinforces what the beer definition and product containing distilled spirits section establish — that Congress never intended to classify beers containing non-beverage flavors as distilled spirits. Internal revenue laws enacted in 1919 prohibited the manufacture of ethyl alcohol for "use in the manufacture or production of any article used or intended for use as a beverage." See Tax on Beverages, 65 Cong. Ch. 18, § 602, 40 Stat. 1105, 1106-07 (1919). Thus, the 1919 internal revenue law demonstrates that Congress recognized that non-beverage "articles" could be used to produce an alcohol beverage, and knew how to prohibit the practice. Yet that statute was repealed, and the conduct it expressly prohibited is not prohibited in today's IRC. Compare I.R.C. § 2837 (1951) with I.R.C. §§ 5 195-96, 5216, 5217 (1954). The absence of a prohibition today accordingly represents a deliberate

choice by Congress, not mere oversight. Indeed, the IRC today states that the presence of

11 This principle, too, is not addressed in the Chief Counsel's opinion on Notice 4. See Counsel Opinion.

taxpaid distilled spirits like the alcohol contained in a non-beverage flavor does not make a product taxable as a distilled spirit. See 26 U.S.C. § 5001(a)(2).

3. The FAA Act Does Not Permit TTB To Limit The Use Of Non-Beverage Flavors In A Malt Beverage

Notice 4 incorrectly proposes to reclassify malt beverages that contain in excess of 0.5% alcohol derived from non-beverage flavors as distilled spirits. See 68 Fed. Reg. at 14296. FMBC members are willing to accept a limit on flavors that requires a majority of an FMB's alcohol to derive from fermentation of the product's base. Nevertheless, FMBC believes that the FAA Act does not support TTB's proposed rule, as it is contrary to the statute's text, its historical context and its legislative history.

On its face, the FAA Act's definition of "malt beverage" grants the brewing industry flexibility in deciding what ingredients and processes to use in producing a malt beverage. Instead of limiting brewers to traditional ingredients in a manner similar to Germany's Reiniheitsgebot, the FAA Act permits a wide range of materials, including "wholesome food products suitable for human food consumption." 27 U.S.C. § 21 1(a)(8). Such wholesome food products include flavors deemed unfit for beverage purposes, as federal law treats flavors and extracts as food. Notice 4 concedes this point. See 68 Fed. Reg. at 14296.

As with the IRC, the historical context of the FAA Act demonstrates that Congress deliberately chose not to prohibit the addition of non-beverage flavors to a malt beverage, even where those flavors contribute most of the alcohol to the finished product. Using non-beverage flavors to create an alcohol beverage is not a new idea: Section 13 of Prohibition's Volstead Act expressly prohibited beverages made from flavors and other non-beverage "articles." 27 U.S.C.

§ 13(e) (repealed). The Volstead Act also limited the alcohol in flavors to that amount absolutely necessary for extraction and preservation purposes. Id. The Volstead Act leaves no

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doubt that Congress knew exactly how to prohibit the manufacture of an alcohol beverage using flavors. Yet just two days after the repeal of Section 13 of the Volstead Act, the same Congress that repealed the Volstead Act did not place within the FAA Act similar restrictions on the use of flavors. In this context, the silence of the FAA Act speaks louder than any text, demonstrating that Congress intended to allow flavors to contribute alcohol to a malt beverage.

A consistent reading of the entire FAA Act provides additional evidence that Congress did not intend to restrict the addition of non-beverage flavors to malt beverages. Significantly, none of the FAA Act's three beverage definitions (malt beverage, wine and distilled spirits) limit the use of flavors in such products. TTB and its predecessors accordingly have never invoked the FAA Act to limit the amount of alcohol that flavors can contribute to wine and distilled spirits. Notice 4 never explains why, after almost 70 years, the FAA Act suddenly requires limits on the use of non-beverage flavors, but only imposes these limits on one of the three primary categories of products regulated under the Act.

The legislative history of the FAA Act further confirms that Congress intended to give brewers flexibility in formulating their products. A general desire to let the brewing industry adapt its practices and processes to meet changing circumstances pervades the legislative history. Indeed, the original Senate version of the Act excluded the brewing industry altogether.

Accordingly, the Act's ultimate inclusion of malt beverages at all came with numerous qualifications 12 designed to preserve industry flexibility. The sole direct reference to the malt

beverage definition in the legislative history states that the definition covers "products of the brewing industry... regardless of their alcoholic content." H.R. Rep. No. 74-1542, at 147 (1935). This reference is significant, as its lack of specificity highlights Congress' desire not to

12 For example, the "penultimate clause" of the Act, 27 U.S.C. § 205.

establish detailed ingredient or production method requirements. The reference attains particular importance when contrasted with the substantial debate that surrounded certain distilled spirit classification issues.

The FAA Act's legislative history also demonstrates that a 0.5% standard would violate the spirit of fair and even competition that motivated Congress to enact the statute in the first place. As explained above, a 0.5% standard apparently is easily achieved by America's largest two brewers, but presents more formidable challenges to FMBC members, particularly small members. The sponsors of the FAA Act wanted "small units to get into the liquor industry," Office of General Counsel, 75th Cong., Legislative History of the Federal Alcohol Administration Act, Pub. L. No. 401, at 19 (1935) (regarding hearings before the House Ways and Means Committee on H.R. 8539), and certainly would not approve of a regulation that might force small units out of the industry. In light of this history, Notice 4's reliance on the FAA Act is ironic indeed.

C. OTHER COMMENTS RELATED TO FMB FORMULATION

1. Timing For Implementation

FMBC members have invested considerable sums over many years in developing, testing and marketing their FMB products. As Notice 4 acknowledges, FMIB producers will need time to adjust to its proposed "substantial change from existing regulations and policy." See 68 Fed. Reg. at 14296. FMBC is not privy to highly-proprietary member company information about the feasibility and amount of time required to develop reformulated products, procure and install new equipment, and take the other steps necessary to introduce reformulated products. FMBC members all agree, however, that TTB should give the industry at least eighteen months from the

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publication of final regulations before requiring that products removed from a brewer's premises comply with a new standard (whether a majority, 0.5%, or something else).

FMBC further urges TTB to draft any final rule in a manner that leaves no doubt about what changes on the effective date of the new rules. Specifically, any new rule should apply only to removals from Internal Revenue Bond or Customs Bond on or after the effective date. FMLBs akeady in the market, whether in wholesalers' warehouses, retailer inventories or with consumers, should remain unaffected by the new formulation standards.

The final rule also should acknowledge that TTB will continue to approve SOPs, pre-import letters and COLAs for FMB products formulated according to current standards up until the effective date of the regulations. Based on past experience, employees of the Advertising, Labeling and Formulation Division ("ALFD") sometimes begin enforcing new regulations or even proposed regulations prior to their effective date. A clear statement that TTB will continue approving SOPs, pre-import letters and COLAs for existing and new products produced under current standards will help avoid confusion in this instance.

2. Proposed Malt Beverage Definition

Notice 4 proposes to add a new "Standards for malt beverages" provision, Section 7.11, to TTB's malt beverage labeling and advertising regulations. See 68 Fed. Reg. at 14301. Part TV.A, supra, explains why TTB should adopt a majority standard requiring that more than 50% of the alcohol in an FMB derive from fermentation of the malt beverage base. Regardless of what standard TTB adopts, FMBC has the following, additional comments concerning proposed Section 7.11:

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i. Placement of New Standards—Sections 7.10 and 7.11

FMBC believes that creating a completely new section for malt beverage standards is

unnecessary. Practitioners and laypersons seeking guidance on the standards for a malt beverage

invariably will look to the definition of that term in Section 7.10 of the regulations, a fact Notice 4 appears to acknowledge by proposing to add a cross-reference to proposed Section 7.11 into Section 7.10. FMBC respectfully suggests that adding new standards directly to Section 7.10 presents a more elegant drafting solution that will prove easier for readers to follow.

ii. Other Ingredients Containing Alcohol — Section 7.11 (a)

Proposed Section 7.11(a) restricts the use of "alcohol flavors or other ingredients

containing alcohol." See 68 Fed. Reg. at 14301 (emphasis added). FMBC supports this recognition that brewers may add to malt beverages other ingredients containing alcohol, such as distilled spirits and wine. Because this portion of proposed Section 7.11(a) represents a departure from existing federal policy, see Ruling 2002-2, FMBC suggests that the final regulations clarify the point by referring to "alcohol flavors, taxpaid wine, taxpaid distilled spirits, or any other ingredients containing alcohol."

iii. Treatment of Malt Beverages — Section 7.11(b)

FMBC applauds Notice 4's recognition that brewers may treat a malt beverage "in order to remove color, taste, aroma, bitterness, or other characteristics derived from fermentation." See 68 Fed. Reg. at 14301. This language recognizes longstanding federal policy that has, until now, remained unwritten. The language of Section 7.11(b) should remain in any final regulations.

iv. Status of Ruling 96-1

Ruling 96-1 limited the contribution of alcohol from flavors to no more than 1.5% ABV in any finished malt beverage containing more than 6% ABV. That 1.5% standard is not consistent with either the 0.5% standard proposed in Notice 4 or the majority standard proposed

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as an acceptable alternative. Notice 4 is completely silent, however, on the status of the existing 1.5% standard for products above 6% ABV. FMBC recognizes that regulations, if finalized, take precedence over informal policy documents like Ruling 96-1. When sup erceding informal rulings, however, FMBC believes TTB explicitly should overrule its prior policy and explain its reasons for doing so.

3. Proposed Beer Definition

Notice 4 also proposes to add a new “Standards for Beer Tax Rate” provision, Section 25.15, to the beer regulations in Part 25. See 68 Fed. Reg. at 14302. Once again, Part JV.A, supra, explains why FMBC urges TTB to adopt a majority standard requiring that more than 50% of the alcohol in an FMB derive from fermentation of the product’s base. Regardless of the standard TTB adopts, FMIBC has the following, additional comments concerning proposed Section 25.15:

i. Placement of New Standards – Sections 25.11 and 25.15

FMBC believes that TTB should not craft a completely new section for its beer standards. FMBC’s position is explained in Part JV.C.2.i, supra.

ii. Permitted Ingredients – Section 25.15(a)

Proposed Section 25.15 allows brewers to use a wide variety of ingredients, including a variety of fruits, in producing a beer. See 68 Fed. Reg. at 14302. By doing so, Notice 4 confirms that the definition of beer allows brewers to use an extremely broad range of materials to produce a product classified as beer. Indeed, existing federal policy permits the use in beer of all the materials listed in proposed Section 25.15.

As written, however, proposed Section 25.15 appears to erase the distinction between beer and wine, as the federal government traditionally has taxed as wine products made primarily

from “honey, fruit, fruit juice, [and] fruit concentrate.” If TTB plans to continue differentiating between wine and beer based on the materials used (e.g., products made primarily from grain qualify as beer, products made primarily from fruit qualify as wine), then TTB must articulate standards by which such determinations will be made. Indeed, we understand that informal TTB policy requires that a majority (more than 50%) of a product’s fermentation material come from grain and/or related products (e.g., corn grits, extracts) in order to qualify as “beer.” But to the best of our knowledge, TTB and its predecessor agencies never have reduced that policy to writing. The law requires agencies to put such standards through the rigors of notice-and-comment rulemaking in order to give interested members of the public notice of such rules, and an opportunity to comment on them. See 5 U.S.C. § 553(b), (c).

SOP submissions (and formula submissions under the regulations proposed in Notice 4) are confidential, non-public documents. As a result, brewers can not know what criteria TTB

applied in deciding whether particular products are beer or wine under the IRC. And because no brewer will have any way of knowing what criteria applied to competing products, a lack of standards invites arbitrary decision making by TTB officials. FMBC accordingly requests that a final rule either clarify that a product fermented with any of the materials listed (regardless of quantity) qualifies as “beer,” or publish proposed regulations that clearly articulate the standards TTB will apply in evaluating whether a product’s ingredients render it a beer or a wine.

iii. Other Ingredients Containing Alcohol – Section 25.15(b)

Like proposed Section 7.11(a), proposed Section 25.15(b) permits the addition to beer of “flavoring materials, taxpaid wine, and other ingredients containing alcohol.” See 68 Fed. Reg. at 14302 (emphasis added). For the reasons articulated in Part IV.C.2.ii, supra, FMBC

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recommend that a final rule permit the addition of “flavoring materials, taxp aid wine, taxpaid distilled spirits, and any other ingredients containing alcohol.”

4. Proposed Formula Provisions 13

Notice 4 proposes to require brewers to file a formula (as the replacement of the current SOP system) wherever the brewer uses “special processing, filtration, or other methods of manufacture that change the character of beer.” See 68 Fed. Reg. at 14302. Notice 4’s preamble explains that this proposed requirement “will help [TTB] to determine whether a particular process may be distillation and thus not eligible to be conducted on the brewery premises.” See id. at 14299. By recognizing the use of modem processing techniques, proposed Section 25.55 provides a welcome codification of existing federal policy. As with proposed Section 7.11(b), FMBC asks TTB to include an explicit recognition of such techniques in any final rule.

Notice 4 does not, however, provide brewers with any information about the criteria TTB will apply in determining when a process qualifies as distillation and how TTB will otherwise evaluate processes and products under its formula rules. Cf 68 Fed. Reg. at 14299. The lack of any criteria raises troubling issues because the information in formulas and TTB’s actions with respect to those submissions will remain highly-guarded trade secrets and qualify as confidential tax return information. See generally 26 U.S.C. § 6102. Without any guidance and with no way of knowing how TTB acted with respect to other products, future product developers will be left guessing about what, exactly, TTB will allow. The system also would invite arbitrary and uneven decision making. FMBC accordingly asks that TTB seek comments on proposed

13 FMBC limits its comments on Notice 4’s formula provisions to the issue that impacts the Coalition’s focus on the FMB category.

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regulations explaining the criteria the Agency plans to use to evaluate when a process constitutes distillation and, more generally, how it will examine beers produced using a “special process.”

D. TTB SHOULD CLARIFY THE LANGUAGE OF ITS PROPOSED LABELING AND ADVERTISING REGULATIONS

Notice 4 proposes to amend Sections 7.29 and 7.54 of TTB’s malt beverage regulations to incorporate the provisions of Ruling 2002-2. See 68 Fed. Reg. at 14298. Stated briefly, that Ruling restricted the use of distilled spirit standards of identity (e.g., rum, tequila and vodka) in malt beverage labeling and advertising, while codifying existing federal policy permitting the use of distilled spirit brand names and cocktail names in the labeling and advertising of malt beverages. See Id. at 14297-98; Ruling 2002-2. For over eighteen months, the policy of Ruling 2002-2 has proved a workable rule that accommodates both the rights of FMB brand owners and the need to prevent consumer confusion, and FMBC therefore supports Notice 4’s desire to incorporate its holdings into the malt beverage regulations. FMiBC believes, however, that the language Notice 4 proposes is ambiguous and fails to accommodate important First Amendment interests of malt beverage advertisers.

Notice 4, borrowing directly from existing wine regulations, see 68 Fed. Reg. at 14298 (citing 27 C.F.R. §§ 4.39, 4.64), proposes to prohibit in labeling and advertising:

Any statement, design, device or representation which tends to create the impression that a malt beverage:

(A) Contains distilled spirits; or
(B) Is similar to a distilled spirit; or
(C) Has intoxicating qualities.

68 Fed. Reg. at 14301 (proposed Section 7.29(a)(7)(i) — labeling), 14302 (proposed Section 7.54(a)(8)(i) — advertising). The proposed rule would be followed by specific exceptions,

including alcohol content statements, use of distilled spirit brand names, and the use of cocktail names as brand or fanciful names. See id.

The language of proposed Sections 7.29(a)(7)(i) and 7.54(a)(8)(i), if applied literally, would prohibit many truthful, non-misleading statements that a producer or importer might wish to make about its malt beverage products. For example, a brewer might want to advertise that a famous drink writer described a beer as “tasting like a fine cognac” or having “the color of dark rum.” Such an attribution would be truthful, and would give consumers added information about the product. Similarly, a number of small brewers today age malt beverages in whisky barrels. Labeling the resulting product a “whisky barrel stout” certainly would not confuse the reasonable consumer about the product and, indeed, would provide the consumer with truthful, accurate information about how the product was produced. The regulations should not prohibit or restrict such infonnation.

By prohibiting many truthful, non-misleading statements, the language proposed by Notice 4 would be bad public policy and violate the free speech guarantee of the First Amendment. Proposed Sections 7.29(a)(7)(i) and 7.54(a)(8)(i) borrow their language from wine regulations first adopted in 1968. See 68 Fed. Reg. at 14298. In the decades since that time, the Supreme Court has extended First Amendment protection to truthful, non-misleading commercial speech — speech that includes statements made on malt beverage labels and in malt beverage advertising. See, e.g., 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484 (1996); Rubin v. Coors Brewing Co., 514 U.S. 476 (1995). The First Amendment requires TTB to tailor its codification of Ruling 2002-2 carefully so as not to prohibit more speech than necessary to protect the public from false or misleading statements. FMBC accordingly suggests that the final

rule replace the language of proposed Sections 7.29(a)(7)(i) and 7.54(a)(8)(i) with the following:

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Any statement, design, device, or representation that tends to create the impression that a malt beverage is a distilled spirit, or that falsely suggests that a malt beverage contains distilled spirits.

FMBC also recommends that the final rule state more clearly TTB's intent to continue with existing policy established by Ruling 2002-2. More specifically, although Notice 4 aims at incorporating existing policy, the preamble also states ambiguously that "use of a distilled spirits brand name in any other malt beverage labeling or advertising contexts would be prohibited under this proposal." 68 Fed. Reg. at 14298. Taken out of context, the forgoing statement may lead some to believe that TTB officials will, at some future date, attempt to restrict labeling and advertising that TTB permits under Ruling 2002-2. Acknowledging that TTB intends no change from existing policy would be helpful.

E. TTB SHOULD REQUIRE ALCOHOL CONTENT LABELING FOR ALL MALT BEVERAGES

FMBC agrees with Notice 4 that alcohol content is important consumer information that should appear on malt beverage labels. See 68 Fed. Reg. at 14297. For this reason, the labels of all FMBs produced or marketed by FMBC member companies bear an alcohol content statement. FMIBC disagrees with Notice 4, however, in its implicit suggestion that FMIBs pose a particular danger for misleading consumers about their alcohol content, and urges TTB to issue final rules requiring alcohol content labeling for all malt beverages.

As it does in attempting to justify the 0.5% standard, Notice 4 asserts the existence of consumer confusion concerning FMB alcohol content without any evidentiary basis for making the claim. Specifically, the Notice claims that consumers are likely to assume that FMBs bearing distilled spirit brand names "are high in alcohol content," 68 Fed. Reg. at 14296, and that consumers of other FMBs may not recognize them "as alcohol products," id. at 14297. As explained in Part lV.A.3.ii, supra, TTB can not rely on speculation or conjecture in attempting to

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assert consumer confusion and must, instead, shoulder a burden to prove consumer confusion. See, e.g., Ibanez, 512 U.S. at 141-42; Edenfield, 770-71. Notice 4's assertion with respect to the alcohol content of FMBs fails to satisfy this burden.

Notice 4 also arbitrarily singles out FMBs for mandatory alcohol content labeling rules. TTB asserts that it proposes to require alcohol content labeling for FMBs based on the use of certain brand names or the use of unspecified labeling and packaging. This reasoning, even if true, is unrelated to the trigger Notice 4 proposes for deciding when a malt beverage must state alcohol content – the presence of non-beverage flavors or other sources of alcohol. See 68 Fed. Reg. at 14301 (proposing Section 7.22(a)(5)). Many existing products made without non-beverage flavors or other alcohol sources have features that TTB claims may lead to consumer confusion about alcohol content. Conversely, many flavored products might have none of the labeling or packaging features that Notice 4 claims may mislead consumers about alcohol

content. In short, the text of proposed Section 7.22(a)(5) bears no rational relationship to the reasoning behind the rule.

More fundamentally, FMBC disagrees with Notice 4's decision to single-out FMBs for mandatory alcohol content labeling when malt beverages made without non-beverage flavors pose at least as much risk of consumer confusion as flavored products. All significant FMBs to date have contained approximately 5% to 5.5% ABV and, to the best of our knowledge, all have placed an alcohol content statement on their labels. In contrast, beers without flavors today range from a low alcohol content of approximately 4% ABV to a high of 25% ABV. See http:/www.whatalesyou.com/beer.asp. Relatively few of these non-flavored beers today state alcohol content on their labels. Given these facts, it is entirely reasonable to conclude that consumers are more confused about the alcohol content of non-flavored malt beverages than

FMBs. Notice 4's contrary conclusion, based on nothing more than speculation, simply does not justify the different treatment it proposes to impose on flavored products.

At bottom, Notice 4 ignores a substantial body of federal policy favoring the disclosure of alcohol content on the labels of all malt beverages. The FAA Act requires alcohol content information on the labels of wine and distilled spirits, see 27 U.S.C. § 205(e)(2), and the Supreme Court's landmark decision in Rubin v. Coors struck down the Act's contrary rule for malt beverages as inconsistent with the First Amendment, see 514 U.S. 476. Since Rubin, the Federal Trade Commission, a federal agency with considerable expertise in consumer-protection issues, repeatedly has recommended that federal law requires alcohol content labeling for all malt beverages. See Alcohol Marketing and Advertising: A Report to Congress (Sept. 2003), Exhibit 20, at 7; Letter from I. Howard Beales, Ill, to George A. Hacker, dated June 3, 2002, Exhibit 21. Indeed, Notice 4 acknowledges that "good reasons" support mandatory alcohol content labeling for all malt beverages. See 68 Fed. Reg. at 14297. Given this overwhelming consensus in favor of alcohol content labeling for malt beverages, TTB should finalize the rules it has been working on for the past ten years. See 27 C.F.R. §§ 7.26 (suspended as of April 19, 1993), 7.71 (interim regulation); see also, 58 Fed. Reg. 24776, 24784 (April 26, 1993) (listing the establishment of alcohol content labeling rules for malt beverages as a final rulemaking item); 68 Fed. Reg. 30760, 30764 (May 27, 2003) (listing the establishment of alcohol content labeling rules for malt beverages as a long-term regulatory agenda item).

F. THE ARGUMENTS OF 0.5% SUPPORTERS

1. Introduction

As TTB is no doubt aware, powerful interests within the alcohol beverage industry have solicited thousands of "form letter" comments in support of a 0.5% standard. This campaign is

impressive when viewed as a demonstration of raw political might. As briefly discussed below, however, none of the arguments put forth by 0.5% standard supporters provides an additional public policy basis for the formulation rule proposed in Notice 4.

2. The Traditions of Beer

The prime "argument" advanced by supporters of the 0.5% standard is that the historical tradition of beer somehow mandates a 0.5% standard. Although FMBC certainly recognizes that the production of beer is an ancient tradition with a long and proud heritage, we find absolutely no reason why that tradition mandates a 0.5% standard. The lack of any connection between beer's history and a 0.5% standard is hardly surprising, as neither the law, consumer perceptions, nor any historic criteria can justify the adoption of the proposed Notice 4 standard over the more reasonable and internally-consistent majority standard.

As explained above, FMBC believes that neither the IRC nor the FAA Act would support any limits on the amount of alcohol that non-beverage flavors can contribute to a beer/malt beverage, beyond the limits arising from the nature of the flavors themselves. See Part JV.B, supra. But even if those statutes could support some limit, TTB itself recognizes that it can adopt a majority standard, see 68 Fed. Reg. at 14296, and such a standard would be more consistent with TTB's treatment of the alcohol source in wines and distilled spirits, see Part IV.A.2.iii, supra. Supporters of the 0.5% standard accordingly attempt to "spin" the legal basis issue by repeating in thousands of letters that Notice 4 "is consistent with" historical interpretations of federal law. Even if true, the mere fact that a standard is "consistent with" a statutory scheme is not support for that standard, a fact driven home by Notice 4's assertion that a majority standard, too, is consistent with the IRC and the FAA Act.

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Similarly, the history of beer provides no basis for concluding that a 0.5% standard is necessary to protect consumer expectations of what an FMB contains. As explained above, see Part IV.A.2, supra, no facts support Notice 4's assertion that FMB consumers know or care about the source of alcohol in an FMB. Absent actual evidence, assertions of confusion by interested industry members do not fill Notice 4's evidentiary void.

Finally, 0.5% standard supporters cast themselves as defenders of "traditional" and "age-old" production techniques. As TTB well knows, however, the brewing industry long ago departed from the brewing methods employed at the time current federal and state alcohol control laws were enacted. Thus, while the federal definitions of "beer" and "malt beverage" do not explicitly mention the use of non-beverage flavors, those statute also do not authorize, among other things: (1) high-tech enzymes to enhance (and perhaps some day replace) fermentation; (2) "high gravity brewing" to produce a high-alcohol concentrate, adding water to make beer just before packaging; (3) new fermentation techniques that have pushed the upper strength limit of beer to 25% ABV (500 proof); and (4) the thousands of "adjuncts" authorized by the BARM.14

At bottom, "tradition" arguments play upon the real differences in taste and appearance between "conventional" beers and most FMBs. But as Notice 4 confirms, see 68 Fed. Reg. at 14301 (proposed Section 7.11(b)), 14302 (proposed Section 25.55(a)(1)), federal policy long ago abandoned any taste, aroma or color criteria for products classified as beer or malt beverages, see, e.g., Miller Letter at 4. Were TTB to assert anything to the contrary, it would have to rethink many products unknown to the drafters of the FAA Act and the IRC. Indeed, supporters of the 0.5% standard take pains to claim that brewers can produce products that look and taste

14 As noted above, the BARM does authorize the use of ethyl alcohol as a flavoring ingredient in malt beverages without any limits, and has since 1980.

exactly like FMBs on the market today under a 0.5% standard. Thus, in a wonderfully ironic twist, supporters of the 0.5% standards wrap themselves in the banner of brewing tradition while championing a rule that will accelerate the development and deployment of high-technology processes necessary to produce an FMB under the Notice 4 standard.

3. The Availability of Same-Tasting FMBs

Supporters of the 0.5% standard trumpet the apparent technological ability of the world's largest brewers to produce FMBs under a 0.5% standard that will look, smell and taste the same as existing products. Even if these claims are true, the demonstration that brewers can meet a particular standard provides absolutely no support for a rule that requires brewers to meet that standard. Like the "tradition" arguments discussed above, claims that some brewers can produce an FMB under the 0.5% standard fail to explain why TTB should adopt that standard.

More fundamentally, government policy should not pick winners and losers in a competitive marketplace. Not all brewers have access to the technology and capital required to

develop processes to treat the malt base in a way that produces a same-tasting FMB under the Notice 4 standard. Moreover, the economies of scale advantages possessed by the largest brewers mean that the costs of complying with any new FMB formulation rule will fall disproportionately on the shoulders of smaller companies. See, e.g., Senate Report No. 96-878 at 3-4 (explaining why increased regulation, even when applied equally to companies of different sizes, provides a competitive advantage to the largest companies at the expense of smaller ones). Viewed in light of these realities, the fact that only a few current FMB brewers support a 0.5% standard, while all can adjust to a majority standard, counsels strongly in favor of the latter rule.

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4. The Orderly Marketplace

Supporters of a 0.5% standard also argue that it is necessary to preserve “orderly markets.” Given that the 0.5% standard would constitute a “substantial change” from existing policy, see 68 Fed. Reg. at 14296, FMBC can not fathom how disruptina the legal status quo preserves order in the market. Instead, by forcing cost increases and possibly changing existing flavor profiles that consumers desire, a 0.5% standard would prove profoundly disorderly to the market. This disorder would only serve to benefit those producers that apparently already can meet the 0.5% standard, and those producers that, by choice or necessity, have chosen not to compete in the FMB segment of the malt beverage market.

FMBC does agree that a TTB standard is necessary to maximize the possibility of national uniformity in FMB regulation. But as explained above, see Part IV.A.4, we believe that a majority standard will provide the uniformity and certainty needed by the states. Once again, then, 0.5% supporters fail to connect their orderly market position to a policy reason for favoring

that rule over the majority standard acceptable to FMBC.

5. The Slippery Slope

Finally, supporters of the 0.5% standard repeatedly argue that allowing beer/malt beverages to contain more than 0.5% alcohol from non-beverage flavors would lead other unspecified producers to attempt to categorize their products as beer. Without more specifics, this “argument” is difficult to address. In any event, FMBC is confident that TTB can evaluate any later requests for equal treatment within the bounds of the statutes passed by Congress. Where, as here, however, a standard does not appear to find support in the law, policy consistency, competition concerns or other reasons, hypothetical later requests do not justify an otherwise-flawed standard.

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More fundamentally, it appears that few other requests will materialize because federal policy towards all beverage categories already is consistent with a majority standard. As

explained above, see Part IV.A.2, supra, federal policy permits wines to contain an unlimited amount of alcohol from added non-beverage flavors or from direct additions of distilled spirits. See 26 U.S.C. § 5373. Distilled spirits, too, can derive up to half of their alcohol from Un-distilled wines. See 27 C.F.R. § 5.11. Finally, a beer/malt beverage can derive alcohol from many sources other than malted barley, or even grain. See 68 Fed. Reg. at 14302 (proposed Section 25.25). Given these current policies, adoption of a majority standard poses no "slippery slope," as the standard would be more consistent with existing federal policy towards the use of various alcohol sources in beer/malt beverages, wines and distilled spirits.

G. PROCEDURAL ISSUES

1. Notice 4 Does Not Comply with the Paperwork Reduction Act

Notice 4's notice under the Paperwork Reduction Act ("PWA"), 44 U.S.C. §§ 3501-

3520, states that the PWA does not apply because "we are not proposing any new or revised recordkeeping requirements." See 68 Fed. Reg. at 14301. The notice is incorrect, however, as Notice 4 proposes a new mandatory labeling requirement for malt beverages that contain non-beverage flavors or other sources of alcohol. See 68 Fed. Reg. at 14301. This new labeling requirement triggers PWA requirements. More fundamentally, the OMB control number cited as authority for proposed Sections 25.55 through 25.58, see id. (citing OMB control number 15 12-0045), does not support the formula rules contained in the proposed regulations.

The PWA applies to any new "collection of information," which the Act defines to include "requiring the disclosure to third parties or the public, of facts or opinions by or for an agency, regardless of form or format." 44 U.S.C. § 3502(3). By requiring producers and

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importers of malt beverages that contain alcohol from flavors to state the product's alcohol content on its label, Notice 4 clearly requires the disclosure of facts to the public. In fact, TTB recognizes that labeling requirements trigger the PWA, as it routinely submits mandatory labeling rules to OMB for review. See, e.g., 68 Fed. Reg. 51064, 51065 (Aug. 25, 2003) (extension of TTB 's requirement that alcohol beverage labels disclose the presence of sulfites). The PWA accordingly applies to Notice 4 because the Notice proposes a new mandatory labeling requirement.

Notice 4 also errs by citing OMB control number 1512-0045 as the basis for its proposed formula regulations. See 68 Fed. Reg. at 14301. Control number 1512-0045 approved TTB's Brewer's Notice form and information requests submitted in connection with a Brewer's Notice. See ATF F. 5130.10 (7-2001), Exhibit 22. But the submission that secured OMB approval never even mentioned the SOP process aside from a cite to the SOP regulation, 27 C.F.R. § 25.67, in a long list of regulations supposedly related to "letterhead applications" and "letterhead notices." See Submission for Approval of Letterhead Applications and Notices filed by Brewers, Exhibit 23, at 2. ATF's description of the information collection and its calculation of the burden associated with the collection request deals exclusively with the Brewer's Notice form, never once mentioning the considerable burden the SOP requirement imposes on brewers. Id. at 3-6. In these circumstances, Notice 4 can not reasonably rely on the approval reflected by control number 15 12-0045 to claim approval of proposed Sections 25.55 through 25.58. See 68 Fed. Reg. at 14302-33.

Even if OMB's approval of control number 1512-0045 did authorize the collection of information authorized by the existing SOP regulation, 27 C.F.R. § 25.67, the substantial difference between that regulation and proposed Sections 25.55 through 25.58 requires TTB to

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seek a new approval of the collections proposed in Notice 4. Current regulations require an SOP where a brewer plans to “produce and market [beer] under a name other than ‘beer,’ ‘ale,’

‘porter,’ ‘stout,’ ‘lager,’ or ‘malt liquor.”’ 27 C.F.R. § 25.67(a). Notice 4 proposes to significantly change the trigger for filing an SOP/formula from one focused on the brewer’s marketing plans to a more complex analysis examining ingredients, processes and final product. More specifically, proposed Section 25.55(a) would require a formula for any beer:

(1) treated by “any special processing, filtration or other methods of manufacture;”

(2) containing taxpaid wine, a non-beverage flavor, or other ingredient containing

alcohol;

(3) containing “coloring or natural or artificial flavors;”

(4) containing “fruits, herbs, spices, or honey;” or

(5) that is “Sake, flavored sake, or sparkling sak&”

68 Fed. Reg. at 14302. Even a cursory comparison of these regulations demonstrates that approving the collection of information under existing regulations does not authorize the very different requirements proposed by Notice 4.

2. Notice 4 Does Not Comply with the Regulatory Flexibility Act

Notice 4 claims that it “will not have a significant impact on a substantial number of entities” because “10 or fewer qualified small breweries actually manufacture flavored malt beverages subject to this rule.” 68 Fed. Reg. at 14301. As such, TTB believes it has satisfied the requirements of the Regulatory Flexibility Act (“RFA”). See 5 U.S.C. §§ 601(3)-(4), 603(a). This conclusion is mistaken, both because more than ten small breweries will be affected by the mandatory labeling rules proposed in Notice 4, and because the proposed rule will have a significant impact on many small wholesalers and retailers.

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FMBC believes the mandatory alcohol content labeling requirement proposed by Notice 4 will affect more than 10 small breweries. Although precise formulation information about

specific products is not available to FMBC, public sources indicate that many small brewers produce flavored products that likely contain at least some alcohol from added non-beverage flavors. This year's Great American Beer Festival ("GABF"), for example, included no fewer than 43 entries in the fruit and vegetable beer category, 16 coffee flavored beers, and 11 "specialty" and 25 "experimental" entries that, in some cases, were flavored. See Great American Beer Festival Winners, Exhibit 24.15 Similar numbers of flavored products appeared at the GABF in prior years. See id. As TTB knows, alcohol makes an excellent carrier for flavors and essences. It is therefore likely that many (though likely not all) of the flavored beers appearing at the GABF derived at least some alcohol from added flavors. TTB can confirm the presence or absence of non-beverage flavors in those products by examining the SOPs that their brewers must submit to TTB. Moreover, small brewers around the country likely produce many other flavored malt beverages that were not entered into the GABF, and imported flavored products surely exist as well. See Tasting Information on Flavored Beers, http://www.tastings.coml, Exhibit 25.

Notice 4's RFA analysis also fails to consider its impact on the vast number of small entities that resell FMBs — licensed wholesalers and retailers. While such small businesses do not produce or import FMBs, they certainly have a substantial stake in the outcome of this rulemaking: FMBs offer wholesalers, and retailers products that generally carry higher profit margins per case than conventional-tasting beer. Moreover, these products expand the range of

15 http://www.beertown.org/events/GABF/02winners.htm.

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products that beer wholesalers and retailers carry, likely helping to sell other products. Indeed, FMBC respectfully submits that the substantial number of small businesses that have filed comments on Notice 4 demonstrates conclusively that TTB must consider wholesalers and retailers in its RFA analysis.

V. CONCLUSION

FMBC supports the need for a national FMB formulation standard and does not wish to obstruct reasonable regulation of the FMB category. But where, as here, a proposed rule would change longstanding policies that a substantial number of businesses and consumers have relied upon, we believe TTB should strive for a standard that minimizes the disruption to all those who relied on prior policy. The majority standard is such a standard, the 0.5% standard is not. Particularly given the lack of any compelling or even stated reasons for favoring the 0.5% standard over the majority standard, we believe the latter should prevail.

FMBC thanks TTB for this opportunity to comment on Notice 4.

Sincerely,

Gregory Altschuh
Administrator
The Flavored Malt Beverage Coalition
cc: FMBC Members (list attached as Exhibit 1)
Marc E. Sorini

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THE ATTACHMENTS FOR THIS COMMENT MAY BE VIEWED IN THE
TTB READING ROOM